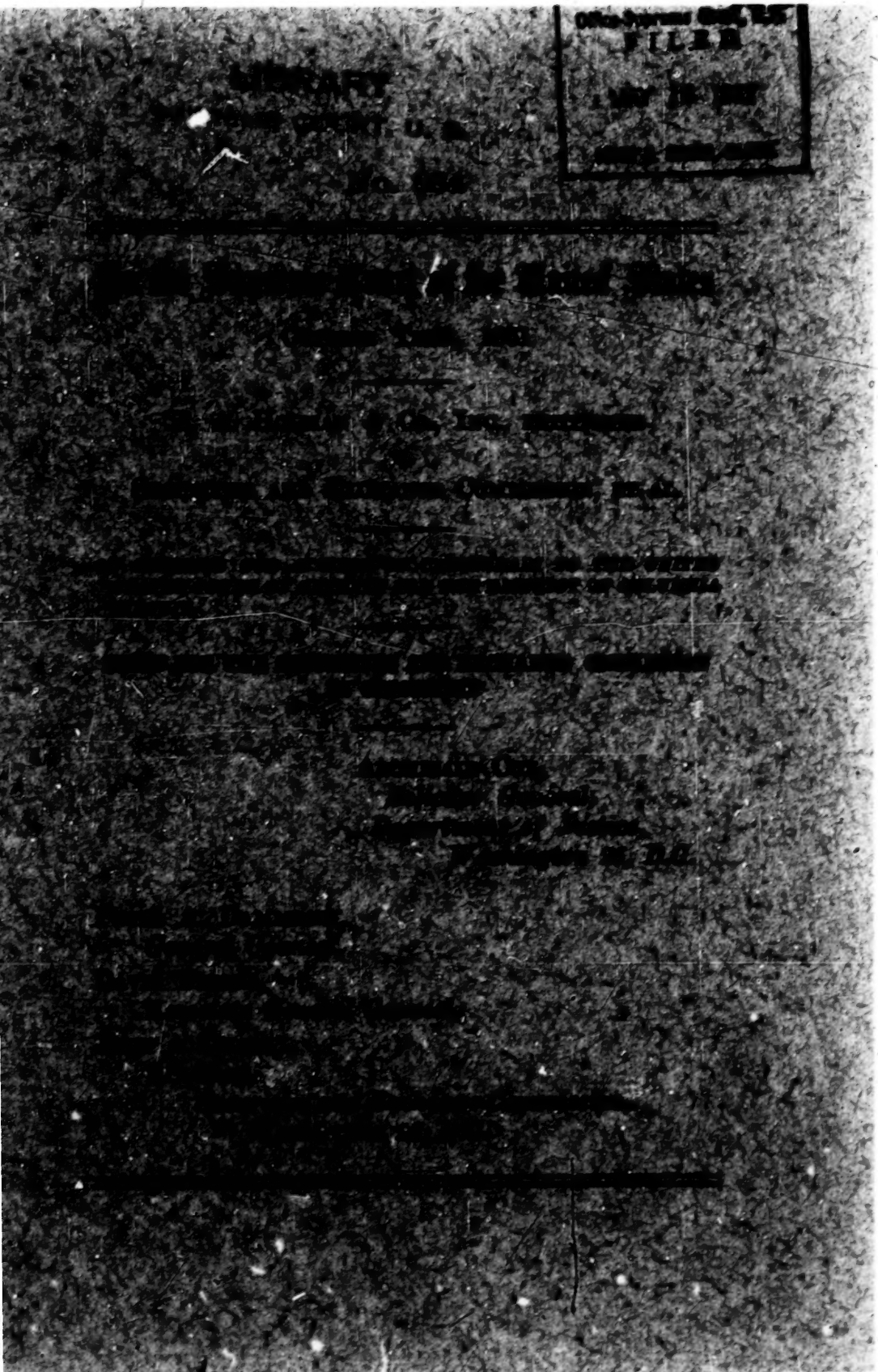

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In the Supreme Court of the United States

October Term, 1961

No. 884

R. A. HOLMAN & CO., INC., PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 28–37) is reported at 299 F. 2d 127. The order of the district court was entered without opinion and is set forth at J.A. 53.

JURISDICTION

The judgment of the court of appeals was entered on January 18, 1962. (Pet. App. 28). The petition for a writ of certiorari was filed on April 17, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the Commission had the authority to promulgate a rule exempting small issues of securities from registration pursuant to Section 3(b) of the Securities Act except where an underwriter of the securities is subject to pending proceedings to determine charges of misuse of the exemption for an earlier issue of securities.

2. Whether petitioner's allegation that a Commission proceeding was instituted by an order issued without a proper quorum being present permits it to seek review of that order by a suit for injunction in the district court, despite Section 9(a) of the Securities Act of 1933, which provides for exclusive review of Commission orders in the courts of appeals.

STATUTES INVOLVED

Pertinent provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and Regulation A, promulgated by the Commission under the Securities Act of 1933, are set forth at pages 38–47 of petitioner's appendix and in the appendix to this brief, *infra*, pp. 14–17.

STATEMENT

Petitioner is a broker and dealer in securities registered under Section 15(b) of the Securities Exchange Act of 1934 and is a member of the National Association of Securities Dealers, a national securities association registered under Section 15A of that Act. In September 1960 the Securities and Exchange Commis-

sion instituted two proceedings involving petitioner (J.A. 9; App. 1, 2, 7).[1]

Regulation A, promulgated by the Commission pursuant to Section 3(b) of the Securities Act of 1933, provides that under certain conditions an issue of securities not in excess of $300,000 may be exempted from the registration provisions of the Securities Act. In reliance on this regulation, petitioner underwrote an issue of 175,000 shares of common stock of Pearson Corporation, which it purportedly offered to the public for $1 a share (J.A. 33–34).[2] The first proceeding against petitioner was instituted on September 16, 1960, when the Commission issued an order under Rule 261 of Regulation A temporarily suspending the exemption for the Pearson issue. The Commission

[1] "J.A." refers to the Joint Appendix. "App." refers to the Appendix to the Commission's brief in the court below.

[2] Materials filed with the Commission in connection with the Regulation A offering had stated that the securities were being offered to the public at $1 per share and it was reported that the entire 175,000 shares had been purchased by the public within 4 days. In reviewing a subsequent registration statement of the Pearson Corporation, the staff of the Commission noted that the Pearson stock thereafter had advanced from the $1 offering price to a high of $13 per share. It was subsequently learned that a substantial block of this stock, which purportedly had been purchased by the "public," had in fact been purchased by Richard A. Holman, president and director of petitioner and by members of his immediate family for their own personal account at $1 per share; that these shares had subsequently been sold back to petitioner at varying prices up to $6.50 per share; and that they had thereafter been resold to the public by petitioner at various prices substantially in excess of the initial offering price of $1 per share (J.A. 34–35).

order stated that the Commission had reasonable cause to believe that the offering of the Pearson stock to the public had exceeded $300,000 and that the exemption was therefore not available, that the sales literature was misleading, and that the offering had operated as a fraud and deceit upon the purchasers. Under Rule 261, any one of these charges is a ground for suspension of the exemption.

The second proceeding against petitioner was instituted on September 26, 1960, to determine whether petitioner's registration as a securities broker and dealer under Section 15(b) of the Securities Exchange Act should be revoked and whether petitioner should be suspended or expelled from membership in the National Association for Securities Dealers (App. 2). Because common questions of law and fact were involved, this proceeding was consolidated on October 31, 1960, with the proceeding under Rule 261 (App. 7). Prior to the commencement of hearings the order instituting the revocation proceeding under Section 15(b) was amended to allege additional violations by petitioner (App. 8).[3]

During the pendency of the consolidated proceedings, petitioner has continued as a registered broker and dealer in securities and a member of the National Association of Securities Dealers. He may act

[3] The additional violations were also the subject of a subsequent proceeding under Section 15(b) of the Securities Exchange Act involving the denial of an application for registration by a former employee of petitioner. That proceeding was at a later date consolidated with the pending proceedings (J.A. 19-20).

as an underwriter of securities issues where a registrant statement is filed pursuant to the provisions of the Securities Act, and the Commission's files show that he has been named as underwriter in connection with such filings. See Commission File Nos. 2-17224 and 2-30223. By reason of Rule 252(e)(2) of Regulation A, however, petitioner cannot act as the underwriter of securities that are unregistered and offered pursuant to the Regulation A exemption until the proceeding instituted under Rule 261 is finally determined in its favor.[1] The record shows that the protracted nature of the consolidated proceedings before the Commission's hearing examiner has resulted in large part from numerous adjournments granted at petitioner's request (J.A. 37-39).

During one such adjournment, in June 1961, petitioner filed its complaint in the district court seeking an injunction against the Commission's proceedings and a declaratory judgment invalidating Rule 252(e)(2). That rule provides that Regulation A is not available to exempt an issue of securities from registration where the underwriter is the subject of pending proceedings under Rule 261 (J.A. 8). In addition to its assertion that this provision is invalid, petitioner also alleged that the Commission's order initiating the proceedings under Rule 261 was issued on the basis of an improper *ex parte* presentation by the staff

[1] If that proceeding is determined adversely to petitioner, the disqualification lasts for a five-year period thereafter. See Rule 252(e)(2). The Commission, however, pursuant to Rule 252(f), may lift the disqualification upon a showing of good cause at any time before or after the determination of the proceeding.

of the Commission and without the presence of a quorum of the Commission. The district court dismissed the complaint (J.A. 53), and the court of appeals unanimously affirmed.

ARGUMENT

The decision below was clearly correct and no question is presented warranting review by this Court.

1. Section 3(b) of the Securities Act makes clear that the Commission is to exercise wide discretion in conditioning exemptions from the registration requirements of the Act. That section authorizes the Commission by rule to grant exemptions from registration for offerings of securities not in excess of $300,000 "subject to such terms and conditions as may be prescribed" by the Commission, where it finds that compliance with the registration requirements is "not necessary in the public interest and for the protection of investors." We submit that Rule 252(c)(2)—which provides that the small-issues exemption is not available when the underwriter is charged with an earlier abuse of the exemption—is a valid exercise of this discretion.

The Commission's experience has led it to conclude that stringent conditions are essential to an exemption under Section 3(b) for the proper protection of the investing public since a filing under Regulation A is not, as petitioner implies, a "short form registration" (Pet. 4). Instead, it is an exemption from registration. Where securities are sold pursu-

[1] Petitioner is not now seeking to raise this issue in this Court.

ant to Regulation A, investors do not have the protection of the complete information contained in registration statements. Independently audited, certified financial statements are not required. The civil remedies against the issuing companies, underwriters, and others that are provided by Section 11 of the Act with respect to misstatements in registration statements are not available for non-registered offerings pursuant to Regulation A.

The importance of the protection attaching to the registration process is emphasized in a report of the House Committee on Interstate and Foreign Commerce relating to a proposed amendment of Section 3(b) of the Securities Act to increase the authorized ceiling of the Regulation A exemption from $300,000 to $500,000. The report stated (H. Rep., No. 1542, 83d Cong., 2d Sess., p. 18 (1954)):

> Regardless of the processing which the Commission may give to the offering circular filed with it under regulation A, or similar regulations pertaining to securities exempted from registration under this section, the remedies available to the investor are limited to those under section 12 of the act; namely, they apply only against the specific individual who may have sold him the security. The investor does not receive the protection of section 11 which, as described above in this report in the discussion of the amendment to section 5 of the 1933 act, provides that as to registered securities,

> he may have remedies against the issuer, its officers and directors, every underwriter, controlling persons, and every accountant, engineer or other expert involved. It is also significant that only in the case of registered securities is there a requirement for independently audited certified financial statements.

The amendment was not enacted."

Regulation A, however, provides an exemption from the protection provided by the registration process. But Rule 252(c)(2) limits the exemption to companies employing underwriters who have not been involved in distributions where abuse of the exemption

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[2] Petitioner points out (Pet. 19, note 9) that Rule 252(c)(2), the challenged provision of Regulation A, was adopted in 1956, and therefore claims that the court below erred in referring to 1954 Congressional reports upon which to base its conclusion that Congress saw nothing objectionable "in Regulation A as a whole, or in Rule 252 in particular." But that statement is supported by the fact that Congress has subsequently, in 1957 and 1959, failed to adopt a similar amendment to raise the ceiling on exemptions under Section 3(b) of the Act. See Hearings before the Subcommittee of the Senate Committee on Banking and Currency, 85th Cong., 1st Sess., S. 810 and S. 843 (1957), pp. 4–6, 9–15; Hearings before the Subcommittee of the Senate Committee on Banking and Currency, 86th Cong., 1st Sess., S. 1178–S. 1182 (1959), pp. 6–8, 116–118; Hearings before the Subcommittee of the House Committee on Interstate and Foreign Commerce, 86th Cong., 1st Sess., Securities Acts Amendments, 1959, pp. 143–144, 149–150. In 1957, the Senate report on such a bill pointed out in a discussion of the anti-fraud features of Regulation A that in 1956 the Commission had revised the regulation, *inter alia*, to make the exemption unavailable if the underwriter of the issuer "has been the underwriter of any other issue which is the subject of a pending * * * suspension order proceeding." S. Rep. No. 438, 85th Cong., 1st Sess., (1957), p. 8. And see also the Commission's 22d Annual Report to Congress (1956), p. 29.

has been found or is currently charged. Because of the civil liabilities of Section 11 of the Securities Act, there has been a cooperative attitude on the part of registrants and underwriters concerning issues of securities to which the exemption does not apply, since "the possibility of putting something over on the Commission and getting by with a less than adequate registration statement is obviously not worth running the risk of being liable for rescission or damages." See, Foster, *Application of the Administrative Procedure Act to the Statutes Administered by the Securities and Exchange Commission*, N.Y.U. School of Law Institute Proceedings, vol. VII (1947), p. 226. The Commission has found, on the other hand, that exemption of securities from registration and civil liability may open a way for evasion by those bent on fraud. See 25th Annual Report of the Securities and Exchange Commission (1959), pp. 4–5. Hence, it was not unreasonable for the Commission to condition the availability of the small-issues exemption upon the employment of presumably responsible underwriters. This is particularly so since the Commission has found that Rule 252(c)(2) does not impede financing by small companies because such companies can normally use other underwriters.

Petitioner contends (Pet. 18–21) that Rule 252(c)(2) is contrary to the pattern of the federal securities acts of providing notice and opportunity for hearing as prerequisites to imposition of a sanction against a broker and dealer in securities. This contention, however, ignores the distinction between complete exclusion from the securities industry, which is the statu-

tory sanction, and a limitation on the privilege of participating in exempt distributions of securities, which is the effect of Rule 252(e)(2). More important, Section 3(b) of the Securities Act gives the Commission authority to formulate the terms and conditions under which exempt offerings of small issues may be made—limited only by the requirement that the Commission must determine, before allowing an exemption, that the public interest and the protection of investors do not require registration. The Commission has reasonably found, on the basis of its experience, that the needs of the investing public require temporary disqualification of underwriters, charged with misuse of the exemption in a previous underwriting, from participating in another exempt issue.

Petitioner is not being denied due process of law on the charges made against it: it is a party to a full evidentiary hearing on all the charges made against it. Petitioner has the right to cross-examine witnesses, to submit briefs, to file exceptions to the recommended decisions of the hearing examiner, and to argue before the Commission. The Commission's determination will be made upon the evidentiary record and, should it ultimately decide to exclude petitioner from the securities industry or impose any lesser sanction, petitioner will have full opportunity to review that determination in a court of

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The cases relied upon by petitioner (Pet. 15), *Greene* v. *McElroy*, 360 U.S. 474, and *Civil Aeronautics Board* v. *Delta Air Lines*, 367 U.S. 316, are clearly distinguishable. Both cases involved a permanent disqualification, in the former upon the basis of a hearing without the right of confrontation and cross-examination, and in the latter without any hearing at all.

appeals. This Court has repeatedly pointed out "that no hearing at the preliminary stage is required by due process so long as the requisite hearing is held before the final administrative order becomes effective." *Ewing* v. *Mytinger & Casselberry*, 338 U.S. 594, 598, and cases cited therein.

2. Petitioner claims that there was no quorum of the Commission present when on September 16, 1960, the Commission instituted the proceeding under Rule 261 charging it with misusing the small-issues exemption in an earlier issue of stock. On this basis, it sought in the district court to enjoin the consolidated proceeding pending against it before the Commission. Both courts below refused the injunction.

We submit the courts below were correct for at least three reasons. First, Section 9(a) of the Securities Act and Section 25(a) of the Securities Exchange Act both provide that orders of the Commission are reviewable exclusively in the courts of appeals. Therefore, the district court had no jurisdiction to enjoin the Commission's proceeding whether or not petitioner's substantive contentions are correct. As the court below stated, the alleged irregularity in the institution of the proceeding may be reviewed only by a court of appeals on review of any final order that might be adverse to petitioner, when the order could be considered in the context of the entire evidentiary

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*If this Court grants the petition, the Commission reserves the right to urge, contrary to the decision of the court of appeals, that Section 9(a) of the Securities Act of 1933 provides that review of Commission orders is exclusively in the courts of appeals and that therefore petitioner could not challenge the action of the Commission by a suit for injunction or declaratory judgment in the district court.

record. This Court has repeatedly held, in similar situations, that judicial review should await exhaustion of the administrative process. See, *e.g.*, *Myers* v. *Bethlehem Shipbuilding Corporation*, 303 U.S. 41; *Securities and Exchange Commission* v. *Otis & Company*, 338 U.S. 843, reversing 176 F. 2d 34 (C.A. D.C.).

Second, subsequent to the order of September 16, 1960, the Commission entered various orders, as to which there is no question concerning the presence of a quorum, ratifying the earlier order. For example, on October 31, 1960, the Commission issued an order directing that a hearing be held on November 21, 1960, on whether the temporary suspension of Pearson's offering should be made permanent (App. 5). The recitation of issues was identical to the reasons set forth in the Commission's order of September 16, 1960, enumerating the reasons for temporarily suspending the Pearson offering. The Commission also entered an order on October 31, 1960, consolidating the proceeding involving the suspension of the Pearson Corporation's exemption from registration with the proceeding seeking the revocation of petitioner's broker-dealer registration, since they involved "several common questions of law and fact" (App. 7).

In any event, petitioner's allegations are insufficient to rebut the presumption of regularity attaching to the Commission's order.[9] The allegations are based on

[9] "The presumption of regularity supports the official acts of public officers and, in the absence of clear evidence to the contrary, courts presume that they have properly discharged their official duties." *United States* v. *Chemical Foundation*, 272 U.S. 1, 14–15. See also *Ross* v. *Stewart*, 227 U.S. 530, 535, and *McGarry* v. *Securities and Exchange Commission*, 147 F. 2d 389, 393 (C.A. 10).

the affidavit of petitioner's president that he "understood" the then chairman of the Commission to have stated that "only two of the five members of the Commission were present at the time the suspension order" was issued (J.A. 13). A quorum of an administrative agency may vote to authorize certain action without being physically assembled together in each other's presence. *T.S.C. Motor Freight Lines, Inc.* v. *United States*, 186 F. Supp. 777, 785 (S.D. Tex.), affirmed *sub nom. Herrin Transportation Company* v. *United States*, 366 U.S. 419. Accordingly, even if only two members of the Commission had been physically present, this fact alone would raise no question as to the existence of a valid vote.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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Solicitor General.

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DAVID FERBER,
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Attorney,
Securities and Exchange Commission.

MAY 1962.

APPENDIX

Securities Act of 1933, 48 Stat 74, as amended, 15 U.S.C. 77a, *et seq.*:

. . .

COURT REVIEW OF ORDERS

SEC. 9. (a) Any person aggrieved by an order of the Commission may obtain a review of such order in the Court of Appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or be set aside in whole or in part. A copy of such petition shall be forthwith transmitted by the clerk of the court to the Commission, and thereupon the Commission shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by evidence, shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the

Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file such modified or new findings, which, if supported by evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The jurisdiction of the court shall be exclusive and its judgment and decree, affirming, modifying, or setting aside, in whole or in part, any order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).

* * * * *

CIVIL LIABILITIES ON ACCOUNT OF FALSE REGISTRATION STATEMENT

SEC. 11. (a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in, the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

* * * * *

Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. 78a, *et seq.*:

COURT REVIEW OF ORDERS.

SECTION 25. (a) Any person aggrieved by an order issued by the Commission in a proceeding under this title to which such person is a party may obtain a review of such order in the United States Court of Appeals within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith transmitted by the clerk of the court to any member of the Commission, and thereupon the Commission shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States

Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, and enforce or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts, by reason of the additional evidence so taken, and it shall file such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, and enforcing or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).

U. S. GOVERNMENT PRINTING OFFICE: 1933